

Letter of Findings: 04-20181338
Gross Retail Tax
For the Tax Years 2012-2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Business did not provide sufficient documentation to prove the Department's assessment of sales tax incorrect.

I. Gross Retail Tax–Audit Methodology.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-3-12; *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014).

Taxpayer protests the Department's statistical sampling methodology.

II. Gross Retail Tax–Exempt Medical Devices.

Authority: IC § 6-2.5-5-18; IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-4-1; *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-36](#); [45 IAC 2.2-2-1](#).

Taxpayer protests the imposition of additional sales tax.

STATEMENT OF FACTS

Taxpayer distributes medical and surgical supplies. The company serves acute-care hospital customers. Taxpayer has a facility in Indiana.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the tax years ending 2012-2014. The Department used a statistical sample that resulted in the determination that Taxpayer owed additional sales and use tax for the tax periods at issue. Taxpayer protested the assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as necessary.

I. Gross Retail Tax–Audit Methodology.

DISCUSSION

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Taxpayer raises two issues in its protest regarding the audit methodology. The first argument Taxpayer raises is that the Department's statistical sample is invalid in that credit memos should have been excluded from the

sample population. Second is that the unrelated third party service center's ("Service Center") activities should be excluded from the sample and assessments.

A. Whether the Department's statistical sample is valid.

Taxpayer protests that the Department's statistical sample is invalid. Taxpayer stated that:

A generally acknowledged restriction on the use of the ratio estimate in an audit situation is that it not be used when the invoice values include both positive and negative values. []. The [Taxpayer's] population contains both invoices and credit memos, with the credit memos naturally representing negative sales amounts or corrections of original invoice amounts. Normally offsetting credit memos would be matched with invoices to eliminate any negative from the frame prior to sample selection, in order to employ a ratio estimate in the manner attempted here. However, this was not done in this audit, as evidenced by credit memos appearing in the sample item.

...

We have reviewed the additional material presented in response to our concerns. However, we do not see support for the computation that was done in our case, especially as it related to the negative sales amounts resulting from credit memos within the frame. Again, we can see that the existence of the credit memos within the sampling frame was addressed by attempting to define the element or value of the audit interest as the exempt or nontaxable amount on each invoice. This is the value that was used as the denominator of the ratio fraction calculation for all invoices, i.e. positive sales amounts. However for the credit amounts (negative sales amounts) the denomination of the ratio fraction that was used appears to be double the credit amounts, expressed as a positive.

IC § 6-8.1-3-12 states:

- (a) The department may audit any returns filed in respect to the listed taxes, may appraise property if the property's value relates to the administration or enforcement of the listed taxes, may audit gasoline distributors for financial responsibility, and may investigate any matters relating to the listed taxes.
- (b) The department may audit any returns with respect to the listed taxes using statistical sampling. If the taxpayer and the department agree to a sampling method to be used, the sampling method is binding on the taxpayer and the department in determining the total amount of additional tax due or amounts to be refunded.

The Department has the authority to use statistical sampling methodology when investigating a taxpayer's business records for tax purposes. Taxpayer challenges the inclusion of the credit memos and that the inclusion of them invalidates the sample. After review of the Department's sampling methodology, the Department treated the credit memos as non-adjustments and no tax was assessed on the transactions.

The Department was able to show that Taxpayer's concerns were taken into account while conducting the statistical sample. Furthermore, no tax was assessed against the credit memos. The Department agrees that the ratio estimator should not be used if the sampling unit contains both positive and negative values. In this case the sampling unit is the "Amount Exempt" field so this principle was not broken. As part of the process to evaluate results the difference estimator was reviewed to confirm that it provides a similar result to the separate ratio estimator used. The separate ratio estimator calculated tax due of X while the difference estimator calculated tax due of X plus \$2,000. These figures support that the use of the separate ratio estimator is valid. In addition, it shows that the use of the difference estimator would not be beneficial for Taxpayer.

Taxpayer has not shown that the Department's statistical sample is invalid. Taxpayer has not met its burden as required under IC § 6-8.1-5-1(c). Thus, Taxpayer's protest regarding the statistical sample including the credit memos is denied.

B. Whether assessing sales tax on transactions from Service Center are correct.

Next, Taxpayer argues that this Service Center, a significant part of their appeal, should be excluded from the sample. Taxpayer stated that the Service Center was audited by the Department for tax years 2012-2014 and that they were assessed additional sales tax. Taxpayer argues that some of the transactions in which additional sales tax was assessed for Service Center is also included in Taxpayer's audit. Taxpayer requested a copy of the Service Center's audit report from the Service Center, but could not obtain it. Taxpayer has provided no additional evidence that there has been any double taxation. Thus, since Taxpayer could not show that the Service Center

paid tax on any of the protested transactions, Taxpayer's protest is denied.

FINDINGS

Taxpayer's protest regarding audit methodology is denied.

II. Sales Tax—Exempt Medical Devices.

Taxpayer protests sales tax assessed on a list of transactions; Taxpayer argues these transactions are exempt. Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a); [45 IAC 2.2-2-1](#). A retail transaction is a transaction made by a retail merchant that constitutes "selling at retail." IC § 6-2.5-1-2(a). Selling at retail occurs when a person "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." IC § 6-2.5-4-1(b). A person who acquires tangible personal property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

There are also various tax exemptions available outlined in [IC 6-2.5-5](#). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, **the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law.**" *Id.* at 101 (internal citations omitted) (**emphasis added**). Thus, in applying any tax exemption, the general rule is that **"tax exemptions are strictly construed in favor of taxation and against the exemption."** *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988) (**Emphasis added**).

With respect to the taxability of tangible personal property purchased by a licensed medical practitioner, [45 IAC 2.2-5-36](#) states:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

- (1) All office furniture, equipment and supplies.
- (2) Drugs of a type not requiring a prescription, when not purchased for resale.
- (3) **Surgical instruments, equipment and supplies.**
- (4) **Bandages, splints, and all other medical supplies consumed in professional use.**
- (5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for professional service. (**Emphasis added**).

The previous version of IC § 6-2.5-5-18, in effect for tax year 2013 until June 30, 2015 i.e. the tax periods at issue, provided, in relevant part:

- (a) Sales or rentals of durable medical equipment, mobility enhancing equipment, prosthetic devices, artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical supplies and devices are exempt from the state gross retail tax, if the sales or rentals are prescribed by a person licensed to issue the prescription.

In this instance, Taxpayer sells the protested items to hospitals and doctors. It is not a person licensed to issue the drugs, devices, or prescriptions. As stated by IC § 6-2.5-5-18 the items "are exempt from state gross retail sales tax, if the sales [] are prescribed by a person licensed to issue the prescription." Taxpayer has not been able to show that these items should be exempt from sales tax, and therefore, has not met its burden as provided by IC § 6-8.1-5-1(c).

FINDINGS

Taxpayer's protest is denied.

SUMMARY

Taxpayer's protest regarding the audit methodology is denied. Taxpayer's protest of the imposition of sales tax is denied.

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An [html](#) version of this document.